

Before the  
Illinois Commerce Commission

In the Matter of

Approval of an Increase and  
Adjustment of Rates and Charges for  
Water Utility Service Sold by  
**Charmar Water Company** within  
Lake County

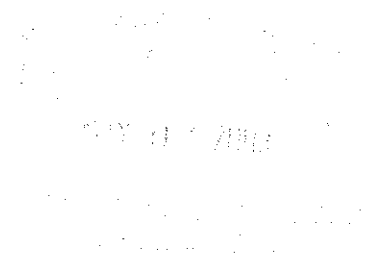
Direct Testimony of

Amanda M. Ross  
Senior Regulatory Accountant

for

Charmar Water Company

May 1, 2003



1   **Q.   Please state your name and business address.**

2   A.   My name is Amanda M. Ross. My business address is 2335 Sanders Road,  
3       Northbrook, Illinois 60062.

4

5   **Q.   What is your occupation?**

6   A.   I am the Senior Accountant for the Regulatory Department of Utilities, Inc. and its  
7       subsidiaries.

8

9   **Q.   Please summarize your professional background?**

10   A.   I have been employed by Utilities, Inc. since April of 2002. Since that time I have  
11       been involved in many phases of rate-making in several regulatory jurisdictions. I  
12       graduated from Purdue University in 2000, and I am a Certified Public Accountant.  
13       I had two years of public accounting/financial analysis experience prior to joining  
14       Utilities, Inc., and I am a member of the American Institute of Certified Public  
15       Accountants.

16

17   **Q.   Please explain your job responsibilities with Utilities, Inc.?**

18   A.   My responsibilities include: financial analysis of individual subsidiaries of Utilities,  
19       Inc., preparation of applications for rate relief, facilitation of commission audits,  
20       and the submission of financial testimony and schedules to support a request for  
21       an increase in rates.

22

23   **Background**

24

25   **Q.   Please describe Charmar Water Company.**

26   A.   Charmar Water Company is a wholly owned subsidiary of Utilities, Inc. (UI). Water  
27       Service Corporation (WSC) manages the operation for all of UI's water and  
28       wastewater systems, including Charmar. WSC provides management,  
29       administration, engineering, accounting, billing, data processing, and regulatory  
30       services for the utility systems. WSC's expenses are assigned directly to a utility or  
31       distributed to the various companies pursuant to a formula that has been approved  
32       by the Commission.

1 Charmar provides water usage service to approximately 53 customers in Lake  
2 County. Charmar's current rate structure was approved on September 20, 1991.

3  
4 **Q. Ms. Ross, what is the purpose of your testimony here today?**

5 A. The purpose of my testimony is to explain to the Commission why Charmar Water  
6 Company has requested an increase in water rates. I will also discuss some of the  
7 factors that have contributed to the need for the increase and the impact of the  
8 increase on our customers. I will present and describe schedules showing the  
9 overall cost of capital and proper rate of return on rate base, and I will also sponsor  
10 the Utility's financial exhibits.

11  
12 In addition, I will provide information to support Charmar Water Company's  
13 request to change depreciation rates from composite rates to class-of-asset rates, to  
14 convert the current bimonthly billing cycle to a monthly billing cycle, and to update  
15 the Rules, Regulations, and Conditions of Service tariffs.

16  
17 **Rate Relief**

18  
19 **Q. Why is Charmar Water Company requesting rate relief at this time?**

20 A. A rate increase is necessary to allow the Utility to recover the reasonable and  
21 prudent costs of providing service and an opportunity to earn a fair and reasonable  
22 rate of return on its invested capital. Rates granted in 1991 do not reflect the 12  
23 years of rising costs, many of which result from stringent federal environmental  
24 regulations, increased investment, and inflation. For these reasons the Utility is  
25 not able to achieve a reasonable rate of return on its investment. Rate relief is  
26 essential to ensure the continued availability of capital at a reasonable cost and to  
27 maintain a high and professional level of service. Under the present rate schedule,  
28 Charmar is not earning a fair and reasonable return on its investment. After  
29 making pro forma adjustments to the December 2002 test year for known, fixed  
30 and measurable changes Charmar Water Company has an overall return of 1.59%.  
31 The proposed rates will allow the company to earn a 9.39% overall rate of return.  
32 This information is supported in the financial statements attached hereto as **Utility**  
33 **Exhibit One.**

1 **Q. Ms. Ross, what factors, or changes in the cost of service, can you point to**  
2 **that have contributed to the need for the requested increase?**

3 A. The age of the system is a factor in the cost of maintenance to be done. As the  
4 system ages, the cost of maintenance increases. In addition, Charmar has spent a  
5 considerable amount of time and money to replace one of the storage tanks to  
6 ensure customer satisfaction and water delivery. Charmar Water Company is  
7 committed to maintaining clean, safe, professional facilities. Our facilities are  
8 visible throughout the communities we serve.

9  
10 **Rate Analysis**

11 **Q. What are the present water rates for Charmar Water Company and when did**  
12 **they become effective?**

13 A. The present usage rates became effective on September 20, 1991, and are as  
14 follows:

15 Base Facility Charges:

16 Residential:

17 5/8" Meter \$12.50

18 Gallonge Charges: \$5.10 per 1,000 gallons

19  
20 It should be noted that these rates are billed bimonthly. The current average  
21 bimonthly consumption for residential customers in Charmar is approximately  
22 10,178 gallons. This equates to a bimonthly bill of \$64.41.

23  
24 **Q. What are the proposed water rates for Charmar Water Company and their**  
25 **impact on the average customer?**

26 A. The proposed rates are as follows:

27 Base Facility Charges:

28 Residential:

29 5/8" Meter \$15.50

30 Gallonge Charges: \$7.38 per 1,000 gallons

31  
32 These rates will be billed monthly pending the Commission's approval of the  
33 Company's request to convert the current bimonthly billing cycle to a monthly  
34 billing cycle. Based on an average consumption of 5,089 gallons per month, the  
35 customers' monthly bill will be \$53.07 or an increase of \$20.87 per month.

1

2 **Cost of Capital**

3

4 **Q. What is the cost of capital of Charmar Water Company?**

5 A. The cost of capital of Charmar Water Company is determined by using UI's capital  
6 structure. These cost of capital percentages are then used to ascertain the overall  
7 cost of capital for Charmar Water Company. The capital structure and cost rates  
8 that I proposed to use in this proceeding are as follows:

9

	<u>Weight</u>	<u>Cost</u>	<u>Weighted Cost</u>
Debt	45.69%	8.64%	3.95%
Equity	<u>54.31%</u>	<u>10.02%</u>	<u>5.44%</u>
Overall	<u>100.0%</u>		<u>9.39%</u>

10

11 **Q. Why must one determine the overall cost of capital for a public utility?**

12 A. The proper balance of rate payer and shareholder interest occurs when the  
13 Commission authorizes a public utility a rate of return on its rate base equal to its  
14 overall cost of capital. If the authorized rate of return on rate base exceeds the  
15 overall cost of capital, then rate payers bear the burden of excessive prices.  
16 Conversely, if the authorized rate of return on rate base is lower than the overall  
17 cost of capital, then the Utility will be unable to raise capital at a reasonable cost.  
18 Ultimately, the Utility may be unable to raise sufficient capital to meet demands for  
19 service, thereby impairing service quality. Therefore, ratepayers interest are served  
20 best when the authorized rate of return on rate base is neither higher nor lower  
21 that the overall cost of capital.

22

23 **Q. Please define "overall cost of capital"?**

24 A. The overall cost of capital equals the sum of the costs of the components of the  
25 capital structure (debt and common equity) after each is weighted by its proportion  
26 to total capital.

27

28 **Q. How does Charmar raise capital?**

29 A. Capital for Charmar is raised by Utilities, Inc. Charmar Water Company is a wholly  
30 owned subsidiary of Utilities, Inc. The source of this capital is banks and large  
31 lending institutions

1 **9. How did you determine the cost of debt to Charmar?**

2 A. The 8.64% cost of debt is the embedded cost of debt of the Utilities, Inc., the parent  
3 company of Charmar, as of December 31, 2002. This percentage is consistent with  
4 past Illinois Commerce Commission practice.  
5

6 **9. How did you derive the cost of equity used in your calculation?**

7 A. Today's embedded cost of debt of the consolidated group is approximately 8.64%.  
8 The equity investor is entitled to a premium over the return to the debt holder  
9 because of the additional risk he or she takes. The debt holder has first claim on  
10 the assets and earnings of the Utility. These claims must be satisfied before funds  
11 are available to the equity shareholder. Therefore, the return on equity must be  
12 greater than 8.64%.  
13

14 In addition, a risk free investment, thirty-year treasury bonds, currently yields  
15 approximately 4.94%, as of April 15, 2003. Utility bonds available to investors are  
16 a higher risk than government bonds. Also available to investors are equity  
17 securities of large companies. These are publicly traded securities paying  
18 dividends and having the advantage of liquidity. Naturally, the market would favor  
19 any of these securities over the equity in a small company with non-traded  
20 securities, such as Charmar. It would be reasonable to add a premium to the cost  
21 of 30-year treasury bonds to determine the cost of equity to Charmar.  
22

23 In addition, in the last rate proceeding (Docket #02-0592), Staff witness Rochelle  
24 Phipps opined that 10.02% is a reasonable cost of equity for one of UI's operating  
25 subsidiaries. In view of the proceeding information, I believe that 10.02% is the  
26 minimum cost of equity and that an overall return of 9.39% is reasonable.  
27

28 **Depreciation**

29  
30 **9. What is the current method of calculating depreciation expense at Charmar  
31 Water Company?**

32 A. Currently, Charmar Water Company multiplies all plant-in-service accounts by a  
33 composite rate of 1.50% to calculate annual depreciation expense.  
34  
35

1 **Q. What method of calculating depreciation expense is the Utility proposing?**

2 A. The Utility is proposing a change from using a composite rate of 1.50% to utilizing  
3 separate depreciation rates for each primary account. These rates range from  
4 1.89% to 7.69%. This method of calculating depreciation expense is consistent  
5 with prior rate proceedings approved by the Commission, including Docket No. 01-  
6 0663, Lake Wildwood Water Company, and Docket No. 02-0592, Del-Mar Water  
7 Company.

8  
9 **Q. Why is Charmar Water Company proposing this change in depreciation rates**  
10 **in order to calculate depreciation expense in this rate proceeding?**

11 A. The Utility has proposed these modified depreciation rates based on testimony filed  
12 by Staff witness King in Docket Nos. 01-0663 and 02-0592. According to this  
13 testimony, separate depreciation rates for primary accounts are more sensitive to  
14 the service life and retirement in a specific account than a composite rate. As  
15 such, rates by primary accounts result in a more accurate allocation and recovery  
16 of depreciation expense. Therefore, the Utility's calculation of depreciation expense  
17 was prepared using the average service lives, salvage values, and calculations  
18 utilized in ICC Staff Exhibit 6.00, Schedules 6.01 and 6.02 for Docket No. 01-0663  
19 and ICC Staff Exhibit 4.00, Schedule 4.04, pages 1 and 2 for Docket No. 02-0592.

20  
21 **Q. How do the depreciation rates proposed by the Utility compare to the rates**  
22 **approved by the Commission in prior rate proceedings?**

23 A. The depreciation rates proposed by the Utility are consistent with the average  
24 service lives, salvage values, and calculations that were approved for Consumers  
25 Illinois Water Company, Northern Illinois Water Corporation, Illinois-American  
26 Water Company, Lake Wildwood Water Company, and Del-Mar Water Company.

27  
28 **Q. What is the effect on Charmar Water Company's depreciation expense using**  
29 **the proposed depreciation rates?**

30 A. Depreciation expense of Charmar Water Company will increase by approximately  
31 \$1,039 based on proposed depreciation rates. In addition, the overall composite  
32 depreciation rates will raise from 1.55% to 2.99%. This increase is consistent with  
33 prior rate proceedings approved by the Commission.

34

1 **Billing Cycles**

2  
3 **9. What is the current billing schedule for the customers of Charmar Water**  
4 **Company?**

5 A. Charmar customers are currently billed at the end of January, March, May, July,  
6 September, and November.  
7

8 **9. What billing schedule is the Utility proposing?**

9 A. The Utility is proposing a change from a bimonthly billing cycle to a monthly billing  
10 cycle.  
11

12 **9. Why is the Utility proposing a monthly billing cycle?**

13 A. The Utility believes that a monthly billing cycle will enable the Utility to provide  
14 better service to the customers of Charmar. First, a monthly billing cycle will  
15 permit Charmar customers to properly budget for water utility expenses each  
16 month. Second, customer service representatives will be able to appropriately  
17 address customer concerns as issues can be promptly detected. Third, the Utility  
18 will be able to locate and resolve system problems as customer billing and  
19 consumption data will be available monthly as opposed to bimonthly.  
20

21 **9. Is this change in billing cycles consistent with the Utility's focus on providing**  
22 **quality service to its customers?**

23 A. Yes, it is. The Utility believes that this change is beneficial to the customers and  
24 the quality of their service.  
25

26 **9. What impact will this change in billing cycles have on operating expenses?**

27 A. The change to a monthly billing cycle will increase office expenses due to an  
28 increase in postage, bank charges, and office stock, such as paper and envelopes,  
29 which results from additional mailings and deposits made throughout the year.  
30 However, no additional employees are required to handle the increased number of  
31 billings.  
32  
33  
34  
35



1 **Rules, Regulations, and Conditions of Service Tariffs**

2  
3 **Q. Does the Utility plan to update the Rules, Regulations, and Conditions of**  
4 **Service tariffs for Charmar Water Company?**

5 A. Yes, it does.  
6

7 **Q. Please explain why the Utility is proposing to update Charmar's Rules,**  
8 **Regulations, and Conditions of Service tariffs.**

9 A. The Utility has proposed to update its Rules, Regulations, and Conditions of  
10 Service tariffs as they have not been updated in more than 12 years. Since this  
11 time, Staff has compiled updated Rules, Regulations, and Conditions of Service  
12 tariffs that have been provided to other Illinois regulated utilities, including  
13 Utilities, Inc., Charmar's parent company. Utilities, Inc. has filed updated Rules,  
14 Regulations, and Conditions of Service tariffs for Docket No. 01-0050, Westlake  
15 Utility, Inc. and has agreed to file these tariffs for Docket No. 02-0592, Del-Mar  
16 Water Company.  
17

18 **Filing Procedures**  
19

20 **Q. Why is Charmar Water Company filing under the Standard Rate Case**  
21 **Procedures instead of the Short Form Procedures that are in place for a**  
22 **company the size of Charmar Water Company?**

23 A. Utilities, Inc. has determined that our short form filings are conducted in the same  
24 manner as a general rate filing. This is because Utilities, Inc. has a staff of  
25 accounting and ratemaking professionals. Additionally, under the short form  
26 process there is no formal procedure for seeking a mediation of disputed  
27 adjustments made by the Staff to the Utility's revenue requirement. This can be  
28 unfair to the Utility.  
29

30 **Q. Does this conclude your testimony?**

31 A. Yes it does.